COUNTY OF SAN LUIS OBISPO

Office of the Auditor-Controller

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TO: DAN BUCKSHI, COUNTY ADMINISTRATIVE OFFICER

FROM: JAMES P. ERB, AUDITOR-CONTROLLER

DATE: APRIL 15, 2013

SUBJECT: ANNUAL DEBT REVIEW

The County's debt management policy contains the following language:
"The County Administrator should report at least once per year to the Board of Supervisors confirming whether the County is in compliance with legal debt limitations and also commenting on the County's overall debt burden as to prudent levels for future budget management and maintenance of strong credit ratings." The Auditor's Office is providing this information pursuant to the debt policy requirement.

Legal Debt Margin:

The County's Comprehensive Annual Financial Report (CAFR) contains a 10 year history of the legal debt margin. As of June 30, 2012, SLO County's legal debt limit was calculated at $516,755,000 based on a factor of 1.25% of total assessed values. The County's total debt applicable to the legal limit was only $11,317,000 so SLO County is safely well under the debt limit. The County was below the legal debt limit for each of the 10 years displayed in the CAFR. There was no new general fund debt issued during fiscal year 2012/2013, so the County remains in compliance with legal debt margins.

Current Debt Burden:

SLO County has several other types of debt outstanding. These include Certificates of Participation (COPs), Pension Obligation Bonds, and Revenue Bonds of various types. These issues are not directly serviced by a levy of property taxes, and so the legal debt limit does not apply. Nevertheless, it is important to carefully monitor and control the level of these obligations. This is to maintain a strong debt rating and to prevent debt service from absorbing too much of available resources. Accordingly, the adopted budget for the County Administrative Office includes a performance measure with the goal of keeping annual general fund backed debt service to no more than 5% of the annual general fund budget. Bond rating agencies generally agree that 5% or less is an indicator of a manageable debt load.

As of June 30, 2012, the outstanding principal balances due as reported in the CAFR are $281,266,000 for business type activities. This is debt of our enterprise funds, the largest portion of which is $193,483,000 for the Nacimiento Water Pipeline. These debts are serviced by charges to users or to contracting cities and districts, not the County General Fund. During the current fiscal year, $5,620,000 of business type debt is scheduled to be retired.

As of June 30, 2012, the CAFR showed outstanding principal balances due of $147,221,000 for governmental type activities. This is debt of our general and special revenue funds, the largest portion of which is $119,429,000 of pension obligation bonds (POBs). During the current fiscal year, $4,770,000 of this debt is scheduled to be retired.

For the current 2012-2013 fiscal year, approximately $2,246,000 of debt service principal and interest on COPs and $8,304,000 on POBs is budgeted to be paid from the general fund. This represents about 2.65% of the general fund budget, significantly within the targeted level of no more than 5%.

Current Status and Outlook:
All scheduled principal and interest payments for fiscal 2012-2013 so far have been made on time.

One of the many requirements to participate in bond issuance is that a biennial credit rating is calculated by an independent rating agency. Credit ratings are used by investors to determine the risk involved on any debt issuance. On May 4, 2012 Fitch reaffirmed the County's implied general obligation rating of AA+. A rating of A is the second highest rating and denotes investment grade debt issuance. AA rating indicates a very strong capacity for payment of financial commitments and is not significantly vulnerable to foreseeable events. Fitch provides this service for 16 California Counties, of which, one was higher (AAA), three are equal (AA), and eleven are lower (A) than San Luis Obispo County. Higher credit ratings result in decreased interest costs.

Recent New Debt:
In mid July the County refinanced its 2002 COP series for $19,750,000. The primary use of these certificates was to partially fund construction of the New Government Center. Prevailing market rates were such that a saving of $3,545,746 will be realized over the life of the bonds.

In May 2012, the Public Works Department sold $83,129,000 in Limited Obligation Improvement Bonds to the United States Department of Agriculture (USDA) to partially fund the Los Osos Wastewater Project. These bonds are not a County General Fund Obligation. At that time $13,648,382 of short term Bond Anticipation Notes were repaid to US Bank. The short term Bond Anticipation Notes were issued in 2010/2011 and are completely paid off.

Anticipated New Debt:

On June 30, 2011 the County entered into financing agreements with the State Water Board for a loan up to $79,920,000 to fund the remainder of the Los Osos Wastewater Project. These funds will be drawn down as needed to complete the project. This is not a County General Fund Obligation.

In May 2013, the Public Works Department anticipates the sale of $1,621,000 in Certificates of Participation to the USDA to fund waterline improvements and tank rehabilitation in County Service Area 10A (Southern Cayucos Water System). This is not a County General Fund Obligation.

Other possible debt issuances within the next year or two could include bond sales to the USDA to fund the State Water Intertie Project in Shandon and Arroyo Grande Creek Levee Improvements. However, the timing and amounts are not certain at this time. These also would not be obligations of the County General Fund.